

Petition of Fitchburg Gas and Electric Light Company for approval of tariffs to provide recovery for costs associated with its obligations to provide employees pension benefits and post-retirement benefits other than pensions.)))))))	D.T.E. 04-48
--	---------------------------------	--------------

August 30, 2004

TABLE OF CONTENTS

I.	INTRODUCTION	1
A.	SUMMARY	1
B.	PROCEDURAL BACKGROUND	2
II.	STANDARD OF REVIEW	2
III.	ARGUMENT	3
A.	THE DEPARTMENT SHOULD DENY THE COMPANY'S REQUEST FOR A BASE RATE INCREASE.....	3
1.	THE COMPANY IS IMPERMISSIBLY "PANCAKING" RATE INCREASES BY SEEKING A BASE RATE INCREASE DURING THE RATE YEAR ESTABLISHED IN ITS LAST BASE RATE CASE.....	3
2.	THE COMPANY FAILED TO PROVE THAT IT NEEDED A RATE INCREASE TO RECOVER ANY ADDITIONAL COSTS	5
B.	THE COMPANY'S PROPOSED RECONCILIATION ADJUSTMENT FACTOR CALCULATION CONTAINS MANY ERRORS AND OMISSIONS.....	6
1.	THE COMPANY FAILED TO CAPITALIZE THE ANNUAL AMORTIZATION OF ITS PBOPS TRANSITION OBLIGATION.....	6
2.	THE COMPANY FAILED TO INCLUDE IN ITS PAF THE REDUCTION IN CARRYING COSTS ASSOCIATED WITH UNITIL SERVICE COMPANY'S PENSION AND PBOPS COST ACCRUALS...	7
3.	THE COMPANY SHOULD NOT BE ALLOWED A RETURN ON PREPAID PENSION COSTS WHEN CUSTOMERS DID NOT RECEIVE THE BENEFITS OF THE CREDITS FROM THE PENSION INCOME.....	8
4.	THE COMPANY FAILED TO ALLOCATE ANY OF THE PENSION AND PBOPS COSTS TO ITS TRANSMISSION FUNCTION.....	9
5.	THE DEPARTMENT SHOULD EITHER INCREASE THE COMPANY'S ASSUMED RETURN ON EQUITY SECURITIES IN	

	THE TRUST FUND OR REDUCE ITS ALLOWED RETURN ON COMMON EQUITY.....	10
6.	THE 2004 AND 2005 PAF FACTOR NUMBERS ARE NOT KNOWN AND MEASURABLE AND MUST BE RECONCILED IN THE FUTURE.....	12
C.	CONCLUSION.....	12

**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

Petition of Fitchburg Gas and Electric Light Company
for approval of tariffs to provide recovery for costs
associated with its obligations to provide employees
pension benefits and post-retirement benefits other than
pensions.

)
)
)
)
)
)
)

D.T.E. 04-48

**INITIAL BRIEF
OF THE ATTORNEY GENERAL**

I. INTRODUCTION

A. SUMMARY

Fitchburg Gas and Electric Light Company (“Fitchburg” or the “Company”) has filed a petition (“Petition”) with the Department of Telecommunications and Energy (“Department”) requesting approval for a rate reconciliation adjustment mechanism to recover alleged pension (“Pension”) and post-retirement benefits other than pension (“PBOP”) obligations the Company is not currently collecting in base rates. Through this mechanism, the Company proposes to implement an annual reconciling rate adjustment factor---the Pension/PBOP Adjustment Factor (“PAF”)---to recover additional Pension and PBOP costs from its gas and electric customers. The Company proposes a PAF of \$0.0159 per therm for its gas division customers and a PAF of \$0.00101 per kWh for its electric division customers. The Department should reject Fitchburg’s Petition because: (1) the Company is impermissibly “pancaking” base rate increases by seeking an increase for costs incurred beginning early in the rate year; and (2) the Company’s methodology in calculating its Pension and PBOP costs and related requirements would result in a gross over-collection from the Company’s customers.

B. PROCEDURAL BACKGROUND

On April 30, 2004, Fitchburg filed its Petition with the Department with supporting testimony by Laurence M. Brock. Exh. FGE-1. On June 3, 2004, the Department issued an Order of Notice indicating that it would hold a public hearing on June 29, 2004. On August 17, 2004, the Department held an evidentiary hearing in this matter.

II. STANDARD OF REVIEW

The Department, after reviewing the propriety of rates under G.L. c. 164, §94, sets rates that are “just and reasonable.” *Attorney General, et al. v. Department of Telecommunications and Energy, et al.* 438 Mass. 256, 264, n.13 (2002).

The Department generally rejects rate increases based on a single issue in isolation. *Default Service*, D.T.E. 02-40-B, p. 18 (2003). The Department has indicated that the single issue rate case bar is, though firmly enforced, prudential, not absolute. *Id.*, p. 20.

The Department has not endorsed a specific method for the calculation of pension and PBOP expense for ratemaking purposes, basing the determination of what is reasonable for each electric and gas distribution company on a case-by-case analysis. *Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company*, D.T.E. 03-47-A, p. 16 (2003) and *Boston Gas Company*, D.P.U. 96-50 (Phase I), p. 81 (1996).

The Department has refused to hear any rate increase application based on a test year that overlaps, in whole or in part, a test year the applicant previously relied on, except when extraordinary circumstances have made a prior order confiscatory. The Department requires such an emergency relief application to explain the special circumstances and their confiscatory effect. *Massachusetts Electric Company*, D.P.U. 19257, p. 12 (1977).

III. ARGUMENT

A. THE DEPARTMENT SHOULD DENY THE COMPANY'S REQUEST FOR A BASE RATE INCREASE

The timing and circumstances associated with the Company's application for a Pension and PBOPs cost adjustment factor are fundamentally different from those when the Department approved adjustments for Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company in D.T.E. 03-47. The Department has found "although precedent sets general rules to guide all companies, each company operates in its own circumstances with its own peculiar features." Boston Gas Company, D.T.E. 03-40, p. 309, n. 130 (2003). As will be discussed below, the Company's circumstances are not those of the other utilities and, therefore, the Department should reject the proposed application. *Id.*

1. THE COMPANY IS IMPERMISSIBLY "PANCAKING" RATE INCREASES BY SEEKING A BASE RATE INCREASE DURING THE RATE YEAR ESTABLISHED IN ITS LAST BASE RATE CASE

The Company asks to recover additional base rate costs that it deferred just days after the beginning of the rate year established in its last base rate case.¹ *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, pp. 114-117 (2002). In that case, the Department specifically considered and recognized the volatility in the factors used to estimate Pension and PBOPs costs. *Id.*, p. 115 (2002).

The Department has refused to hear any rate increase application based on "pancaking" of rate cases. The Department's prohibition against rate case pancaking is well established:

Rates properly established will result in a reasonable return at the time of the

¹The Company requested, and the Department approved, an accounting deferral of Pension and PBOPs costs beginning January 1, 2003, less than thirty days after the beginning off the rate year in D.T.E. 02-24/25. *Fitchburg Gas & Electric Light Company*, D.T.E. 02-83.

investigation and for a reasonable time thereafter. *McCardle v. Indianapolis Water Company*, 272 U.S. 400, 410; 47 S. Ct. 144, 148 (1926). It is such a result that this Department attempts to establish in its rate decisions and which was in fact established in D.P.U. 18599. Re-determination cannot be had at frequent intervals, and consequently a determination that gives recognition to the future is to be sought. *Indianapolis Water Co. v. McCart*, 89 F.2d 522, 526 (7th Cir. 1937). That is the purpose of allowing adjustments to the test year figures. Our decision in D.P.U. 18599 contains numerous such adjustments, made in the expectation, based on the facts of record, that they would produce reasonable rate for the future. *Massachusetts Electric Company*, D.P.U. 19257, p. 7.

To relitigate, only a short time later, a matter decided after full opportunity for evidence and argument would be an abuse of the administrative process. Any agency would be sorely beset were it to face an influx of applications based on the bolstering up of evidence on issues recently decided against the applicant. *Id.*, p.10.

The Department does make an exception to its prohibition against pancaking where extraordinary circumstances have made a previous rate order confiscatory. *Massachusetts Electric Company*, D.P.U. 19257, p. 12 (1977). The Department requires such an emergency relief application to explain the special circumstances and their confiscatory effect. *Id.* The Company has not filed an application for emergency rate relief showing a cost of service revenue deficiency as required under the pancaking standard. *Attorney General, et al. v. Department of Telecommunications and Energy, et al.* 438 Mass. 256, 264, n.13 (2002). Fitchburg merely states, without proof, that severe financial harm will result unless the Department approves its application. Exh. FGE-1, p. 21. Without the required showing, the Department should deny the Company's request to recover costs deferred during the rate year.² *Massachusetts Electric Company*, D.P.U. 19257, p. 12 (1977).

² The Department, in an analogous situation, found that NSTAR could not collect Pension and PBOPs costs during a rate freeze period. *Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company*, D.T.E. 03-47-A, pp. 32-33 (2003):

The Department cannot permit companies to retain all potential savings realized by picking and choosing the costs that will be absorbed during a rate freeze.

2. THE COMPANY FAILED TO PROVE THAT IT NEEDED A RATE INCREASE TO RECOVER ANY ADDITIONAL COSTS

The Company did not prove that it needed to recover the difference between its annual pension and PBOPs costs and the associated amounts in base rates. The deferral of Fitchburg's balance or prepaid pension costs may be appropriate to avoid a writeoff. The Company did not show, however, that it would suffer financial harm unless the Department approved the recovery of the difference between the amount of annual pension and PBOPs expense and the amount recovered through base rates.

The Company also failed to inform the Department of coincident cost reductions that eliminate the need for the deferral of pension and PBOPs expense. The Company had been planning a management restructuring during the last quarter of 2002 that would dramatically reduce its cost of service. Tr. 1, p. 41. Specifically, Unitil (Fitchburg's parent company) stated:

In December 2002, Unitil committed to a formal management transition and reorganization plan to streamline its management structure and to improve efficiency to meet ongoing business requirements. The Company estimates this reorganization will result in an annual cash savings of approximately \$2.3 million in operating expenses and construction project overheads in future periods. Exh. AG-5, p. 12.

Fitchburg knew of the annual \$920,000³ decrease in costs when it filed its request for an accounting deferral of its Pension and PBOPs costs in December of 2002. The Company, however, failed to inform the Department of this important fact that would outweigh the amount of Pension and PBOPs expenses that it expected to defer.

Fitchburg also failed to produce this management restructuring during its base rate case

³Fitchburg may not see all \$2.3 million in savings, since Unitil Service Company is realizing the majority of these cost savings. The Company, however, can expect to receive approximately 40 percent of those cost savings, or \$920,000 per year. [$\$920,000 = \$2,300,000 \times 0.40$]. Exh. FGE-1, Sch. LMB-4, Line 6.

proceeding in D.T.E. 02-24/25, even though the Attorney General asked the Company during discovery in that case to produce any studies done by or for the Company regarding its management:

REQUEST AG-1-8 Please provide a copy of any and all management, organizational, construction, and performance audits of any kind of the Company and any of its affiliates performed by company personnel, contractors, consultants, any regulatory body, or any organization or individual whatsoever during the last five years.

RESPONSE: During the last five years, there have been no management, organizational, construction, or performance audits of the Company or any of its affiliates. The only audits of the Company or any of its affiliates that have been performed during the last five years are financial and operational in scope.

See Fitchburg Gas & Electric Light Company, D.T.E. 02-24/25, Exh. AG-1-8 which is attached to this brief.⁴ *See also Id.*, pp. 32-33 (2002)(reminding the Company about its obligation to update information that is no longer true or complete). The Department should reject the Company's request in total and sanction the Company for selectively disclosing only costs that are increasing, while failing to mention costs that it knows are decreasing or about to decrease.

B. THE COMPANY'S PROPOSED RECONCILIATION ADJUSTMENT FACTOR CALCULATION CONTAINS MANY ERRORS AND OMISSIONS

The Department should also deny the Company's proposed recovery of its pension and PBOPs costs because it is fraught with errors and omissions.

1. THE COMPANY FAILED TO CAPITALIZE THE ANNUAL AMORTIZATION OF ITS PBOPs TRANSITION OBLIGATION

Fitchburg did not capitalize any portion of the annual amortization of its PBOPs

⁴ The Attorney General requests, pursuant to 220 CMR 1.10(3), that the Department incorporate by reference Exhibit AG-1-8 from *Fitchburg Gas & Electric Light Company*, D.T.E. 02/24/25.

transition obligation in calculating its PAF. Exh. DTE-11. The accounting rules of the Federal Energy Regulatory Commission and the Department require that the labor costs associated with construction be capitalized and included in the appropriate plant account. *See* 18 CFR 1.101, Electric Plant Instruction No. 3. Utilities, therefore, typically assign Pension and PBOPs costs in part to their construction activities and capitalize and include these costs in the balance of plant in service. *Id.* They expense the remaining amount in the year that they incur it.

The Company claims that the amortization of transition obligation is not a current expense, and therefore they should not capitalize and include it in current construction costs. Exh. DTE-11. On the other hand, the Company seeks recovery of the amortization of these costs from customers as though it were a current expense. Tr. 1, p. 4. Either the amortization of the transition obligation is not a current cost and the Company should not write off the transition obligation immediately, in its entirety, or it is a current cost that should be assigned to both the income statement and construction. Since the Company has chosen to recognize the transition obligation as a current expense, the Department should order the Company to capitalize the annual amortization of its transition obligation.

2. THE COMPANY FAILED TO INCLUDE IN ITS PAF THE
REDUCTION IN CARRYING COSTS ASSOCIATED WITH UNITIL
SERVICE COMPANY'S PENSION AND PBOPs COST ACCRUALS

The Company did not credit customers through the PAF for the reduction in carrying costs associated with Unitil Service Company's Pension and PBOPs cost accruals. Fitchburg includes adjustments in its PAF for the difference between the annual Pension and PBOPs expense that the Company records for financial purposes and the amount it recovers from customers through base rates, along with carrying charges associated with the net amount of

Prepaid / Accrued Pension and PBOPs Cost.⁵ The Company proposes to include certain of the Pension and PBOPs costs associated with Unitil Service Company in the PAF, since the Service Company directly assigns and allocates its costs to Unitil's operating companies. Fitchburg, however, failed to credit the amounts of Pension and PBOPs accruals to the balance earning carrying charges.

The Company charges the difference between the annual Unitil Service Company Pension and PBOPs expense that the Company records for financial purposes and the amount it recovers from customers through base rates, which amount to \$226,486 in 2003 and \$544,524 in 2004. Exh. DTE-9, Sch. LMB-2,4,5. The Company, however, fails to credit any of the amounts of Pension and PBOPs accruals to the balance earning carrying charges. These accruals were \$736,029 in 2003 and \$1,251,715 for 2004. Company witness Brock could not justify this failure, claiming only that these accruals are on the Service Company's balance sheet and not Fitchburg's, thus customers get only the costs from the Service Company and not any of the benefits associated with providing the service.

The Department should reject this asymmetrical treatment of the Service Company costs that is unfair to customers. If the Company is allowed to recover any of the Service Company Pension and PBOPs costs, it must also pass on any benefits associated with those employee benefits. The Department should order the Company to include the Service Company Pension and PBOPs accruals of \$736,029 for 2003 and \$1,251,715 for 2004 in the determination of any carrying charge it allows on the Prepaid / Accrued Pensions and PBOPs costs.

3. THE COMPANY SHOULD NOT BE ALLOWED A RETURN ON
PREPAID PENSION COSTS WHEN CUSTOMERS DID NOT

⁵ Prepaid amounts would increase the balance receiving carrying charges and Accrued amounts would reduce that balance.

RECEIVE THE BENEFITS OF THE CREDITS FROM THE PENSION INCOME

The Department should deny recovery of carrying charges associated with the net amount of Prepaid / Accrued Pension and PBOPs costs when the Company has not been flowing through to customers the net income from the pension funds. The Department did allow both Boston Gas Company and the NSTAR Companies to recover carrying charges on their Prepaid Pension and PBOPs costs. *Boston Gas Company*, D.T.E. 03-40, pp. 311-312 (2003); *Commonwealth Electric Company, Cambridge Electric Light Company, and Boston Edison Company*, D.T.E. 03-47, pp. 36-38 (2003). Neither company, however, reduced the pension income that it was receiving from its trust funds to zero.

Fitchburg, in its last base rate case, removed from the cost of service the Pension income from its trust fund. Exh. AG-1, pp. 1, 3. Thus, customers did not receive the benefit of the pension income when the plan was over-funded. It is unfair for the Company to charge customers for carrying charges on any prepaid balance, when they never received the benefit of the income in the first place. Therefore, the Department should deny the Company's request to recover carrying charges on the Prepaid Pension Costs.

4. THE COMPANY FAILED TO ALLOCATE ANY OF THE PENSION AND PBOPs COSTS TO ITS TRANSMISSION FUNCTION

The Company proposes to charge the transmission portion of the PAF to the distribution function. Exh. AG-4. A basic principle of setting regulated utility rates is that the rate should recover only the costs required to provide that service. Massachusetts law requires electric utilities that divested non-nuclear generation to unbundle their distribution and transmission functions. G.L. c. 164 §1A(b)(1). The Department specifically directed the Company in its last rate case to run its functional cost of service study to properly allocate costs and expenses

between the distribution and the transmission functions, since the Company, in that case, failed to remove all of the costs that were attributable to the transmission business. *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, pp. 234-235 (2002).

Fitchburg did unbundle its distribution and transmission rates as it went through restructuring. The Company, however, has failed to allocate any portion of the PAF increases to the transmission business. To the contrary, the Company specifically states that those costs will stay in the PAF for distribution service. Exh. AG-4.

The Department should again order the Company to adjust the distribution PAF to remove those Pension and PBOPs cost adjustments associated with transmission service.

5. THE DEPARTMENT SHOULD EITHER INCREASE THE COMPANY'S ASSUMED RETURN ON EQUITY SECURITIES IN THE TRUST FUND OR REDUCE ITS ALLOWED RETURN ON COMMON EQUITY

The Company has overstated its Pension and PBOPs costs by grossly understating the expected return on equity securities in its trust funds. The annual Pension and PBOPs cost calculations depend on many variables. *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, pp. 114-117 (2002). Variables common to both calculations include the number of employees, the expected years of retirement, and the discount rate used to express the future cash flows in present dollars. *Id.* One of the significant variables is the return on the investments in the trust fund that is credited to the annual cost. Exh. AG-8, p. 123.

Fitchburg's trust funds are invested in equity and debt securities, and it invests in the equity securities of the Standard & Poor's 500 Companies ("S&P 500"). Tr. 1, pp. 65-68. The Company must estimate the earned return on the equity investments in its trust fund to calculate its annual Pension and PBOPs cost. Although the Company forecasts return on equity of the

S&P 500 at less than 10 percent, the Department set rates for the Company using a 10 percent return based on an expected return for electric distribution companies. Exh. AG-RR-3; *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, p. 230 (2002).

The Company again has been inconsistent and unfair to its customers. The higher 10 percent allowed return on common equity increases the return on rate base the Company recovers from customers. At the same time, the lower rate of return assumption on S&P 500 equity securities in the trust fund increases the annual pension cost. The Department should reject this artificial increase in pension cost.

The Department should require that the Company's assumption for the return on equity assets in the Pension and PBOPs trust funds be consistent with the return that the Department allows in the Company's last base rate case. Since the Department has found that electric distribution companies' investment risk is less than that of the S&P 500, the expected return on common equity for an electric distribution service company should be below that of the S&P 500. See *Fitchburg Gas & Electric Company*, D.T.E. 99-118, p. 87 (2001); and *Boston Edison Company*, D.P.U. 906, p.103 (1982). The Company's allowed rate of return on common equity in its last base rate would be too low an estimate of the expected rate of return for S&P 500 equity securities.

Fitchburg's cost of capital witness in D.T.E. 02-24/25 calculated a range of 13.1 to 13.4 percent cost of equity for the S&P 500, using a risk premium analysis. *Fitchburg Gas and Electric Light Company*, D.T.E. 02-24/25, p. 218 (2002). This range of S&P 500 cost rates has a midpoint of 13.25 percent. The Company's witness also calculated a cost of equity financing of 12.0 percent for electric utilities and 11.9 percent for gas utilities, using the same risk premium methodology. *Id.*, pp. 217-218. The differences between the S&P 500 and the Utilities' costs of

equity are 1.25 percent ($1.25 = 13.25 - 12.0$) for the electric utilities and 1.35 percent ($1.35 = 13.25 - 11.9$) for the gas utilities. The midpoint of this range is 1.3 percent. The Department determined that the cost of equity capital for Fitchburg is 10.0 percent. *Id.*, p. 230. Adding the Company's cost of common equity for Fitchburg of 10 percent to the 1.3 percent equity premium for the S&P 500 yields an expected return on common equity of 11.3 percent based on the Department's findings in D.T.E. 02-24/25. To be consistent, the Department should find that the equity securities in the Company's trust funds are expected to earn an 11.3 percent return, and order the Company to use that assumption in determining its annual pension and PBOP costs.

6. THE 2004 AND 2005 PAF FACTOR NUMBERS ARE NOT KNOWN AND MEASURABLE AND MUST BE RECONCILED IN THE FUTURE

The Company includes in its proposed PAF 2004 Pension and PBOPs adjustment factor components as though they are “known and measurable” amounts. Exh. FGE-1, Sch. LMB-1. Since the Company will not close its books and determine the amounts capitalized to construction for calendar year 2004 for more than four months, it is impossible to know the exact measures of these costs until next year. Tr. 1, p. 20. Therefore, the adjustments for 2004 and 2005 are not final, known and measurable and must still be reconciled to actual sometime in the future.

C. CONCLUSION

For all of the above reasons, the Department should deny the Company's proposed Pension and PBOP's reconciliation adjustment and reject any increase in rates at this time. To the extent that the Department allows recovery of any of the Pension and PBOPS cost changes, it should make the six adjustments to the Company's proposed calculations the Attorney General

proposes to correct errors in those calculations.

Respectfully submitted,

TOM REILLY
ATTORNEY GENERAL

By: _____
Wilner Borgella, Jr.
Assistant Attorney General
One Ashburton Place
Boston, MA 02114
(617) 727-2200

Dated: August 30, 2004